

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }  
SEYMOUR AND JEANETTE LEWIS }

For Appellants: Philip R. Storrer  
Certified Public Accountant

For Respondent: John A. Stilwell, Jr.  
Counsel

O P I N I O N

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Seymour and Jeanette Lewis against a proposed assessment of additional personal income tax in the amount of \$1,075 for the year 1979.

Appeal of Seymour and Jeanette Lewis

The sole issue for determination in this appeal is whether appellants have met their burden of **proving** their entitlement to a bad debt deduction for losses of moneys advanced to their son-in-law and later to their **daughter** and son-in-law.

On their joint personal income tax return for 1979, appellants reported a bad debt on an uncollectible note to their son-in-law, Gerald Wyrick, in the amount of \$2,500, and to their daughter and son-in-law in the amount of \$7,425, as capital losses on assets held one year or less, i.e., as non-business bad debts. Appellants also claimed an ordinary loss of \$18,966 on a secured note **co-signed on** behalf of their daughter and son-in-law for business purposes, i.e., a business bad debt.

Respondent requested further information about each of the claimed bad debts. In reply, appellants provided the following information.

On August 1, 1973, appellants loaned \$2,500 to Gerald Wyrick, their son-in-law, to enable him to purchase an automobile. A promissory note was signed by Wyrick which provided for interest at the rate of 6 percent annually payable in 36 monthly **installments of** \$76.00 commencing August 15, 1973. Appellants never received any payments pursuant to this note. Appellants did not attempt to collect this note because Wyrick's "corporation was insolvent and Gerald Wyrick had no assets."

On December 1, 1974, appellants loaned \$7,425 to Gerald Wyrick and his wife, appellants' daughter. The proceeds of the loan were to be used on the down payment of the Wyrick's residence. The promissory note signed by the Wyricks provided for "simple" interest, payable "as available." Appellants never received any repayment on this note and never attempted to collect from Wyrick or his wife because of their "insolvency."

On October 31, 1977, the Wyricks obtained a \$22,000 business loan for their business, The Upholstery Shoppe, Inc., from First Interstate Bank of California. (formerly United California Bank). On September 20, 1978, appellants personally borrowed **\$18,966.30** from the bank and paid the balance of the Wyrick's note, to enable the Wyricks to obtain additional financing from the bank. Appellants state that the Wyricks agreed to repay appellants, but there is no evidence that the **Wyricks ever**

Appeal of Seymour and Jeanette Lewis

executed a note creating such indebtedness, and they never repaid any of the amount paid by appellants to the bank. Appellants made the final payment on the note to the bank on October 17, 1979. Again, appellants made no attempt to collect on this debt from the Wyricks.

The Upholstery Shoppe temporarily suspended operations at the start of 1979. Later that year the Wyricks separated and subsequently divorced.

Respondent issued a proposed assessment against appellants disallowing the claimed bad debt deductions on the basis that (1) there was no bona fide indebtedness created because appellants made advances to the Wyricks with no reasonable expectation for repayment, and (2) the payment of the Wyrick's note by appellants was done without consideration, solely as an accommodation to their daughter and son-in-law. Appellants filed a timely protest, stating that payment of the Wyricks' note was done for consideration and that at the time the loans were made, they had reasonable expectations that the loans would be repaid and **were** always willing to enforce payment. In a letter to respondent dated April 27, 1981, appellants stated that: (i) they had loaned Wyrick \$4,500 which he repaid prior to appellants' payment of the Wyricks' bank note; (ii) their payment of the Wyricks' bank note was necessary because the Wyricks could not provide the necessary security required by the bank for the additional financing they needed; (iii) appellants expected to receive no benefit from their payment of the Wyricks' note other than to assist their son-in-law in carrying out his business ventures; (iv) the debts had value at the beginning of 1979 because Mr. Wyrick was still in business; and (v) the debts became worthless in 1979 **because** Wyrick closed his business during that year.

After due consideration of the protest, respondent affirmed its proposed assessment. This timely appeal followed.

Respondent argues that appellants have failed to establish that bona fide debts existed and that even if it is determined that bona fide debts existed, appellants have failed to establish that the debts had any value at the beginning of taxable year 1979.

Section 17207 of the Revenue and Taxation Code allows as a deduction any debt which becomes worthless

Appeal of Seymour and Jeanette Lewis

within the taxable year. Respondent's **former regulation** on this subject provided:

Only a bona fide debt qualifies for purposes of Section 17207. A bona fide debt is a debt which arises from a debtor-creditor relationship based upon a valid and enforceable **obligation to** pay a fixed or determinable sum of money.

(Former Cal.. Admin. Code, tit. 18, reg. 17207(a), **subd. (3)** (repealer filed April 16, 1981; Register 81, **No. 16**)).

We have in the past looked with particular scrutiny at loans or advances made to family members. (See Appeal of Barry P. and Florence O. Warner, Cal. St. Bd. of Equal., April 22, 1975; Appeal of Arthur and Kate C. Heimann, Cal. St. Bd. of Equal., Feb. 26, 1963.) **No deduction** for a bad debt based upon such a transaction is allowed unless there is an affirmative showing that there existed at the time of the advance a real expectation of repayment and an intent to enforce collection. (E. J. Ellisberg, 9 T.C. 463 (1947); Evans Clark, 18 T.C. 780 (1952); Leonard Henly Bernheim, ¶ 50,277 P.H. Memo. T.C. (1950).)

Applying the same close scrutiny to the instant case, we must conclude that the loans made by appellants to the Wyricks did not constitute bona fide loans. Although Mr. Wyrick signed a promissory note for \$2,500 and both Mr. and Mrs. Wyrick signed a note for the \$7,425 advance, no note or other indicia of indebtedness was obtained for the payment of the bank note. Additionally, appellants never required the Wyricks to make any payments on either loan. There is no indication that any security was obtained on any of the loans. Although no payments were ever received on the 1973 loan, appellants continued to loan money in 1974 and in 1977. We must conclude from this fact that appellants had no reasonable expectation of repayment on any of these loans.

The record is also devoid of evidence which would lead us to conclude that appellants intended to enforce collection of the loans. Appellants have stated that they did not institute legal action against the Wyricks because they were insolvent. They have offered no reasons why they did not pursue collection of the 1973 and 1974 loans at an earlier date while the Wyricks' business was still in operation and they were supposedly "solvent." Additionally, except for the statement that

Appeal of Seymour and Jeanette Lewis

the Wyricks' business closed, appellants have offered no evidence to prove that the Wyricks actually were insolvent and without any assets or resources with which to repay the loans.

For the reasons above, we must sustain respondent's action in this matter.

Appeal of Seymour and Jeanette Lewis

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Seymour and Jeanette Lewis against a proposed assessment of additional personal income tax in the amount of \$1,075 for the year 1979, be and the same is hereby sustained.

Done at Sacramento, California, this **13th** day of December , 1983, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg and Mr. Nevins present.

William M. Bennett , Chairman  
Conway H. Collis , Member  
Ernest J. Dronenburg, Jr. , Member  
Richard Nevins - - - - , Member  
\_\_\_\_\_, Member